United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-5009

To be argued by
ALBERT LYONS

B

P/S

In The

UNITED STATES COURT OF APPEALS

For the Second Circuit

In re

UNISHOPS, INC., MIDDLETOWN CENTER, INC.,

Debtors,

Docket No. 76-5009

143 ESTATES, INC.,

Appellant,

vs.

UNISHOPS, INC., MIDDLETOWN CENTER, INC.,

Appellees.

On Appeal from an Order of the United States District Court for the Southern District of New York.

APPELLANT'S REPLY BRIEF

RUBEN SCHWARTZ & SILVERBERG
Attorneys for Appellant
Office & P.O. Address
450 Seventh Avenue
New York, NY 10001
(212) 695-3550

ALBERT LYONS
SEYMOUR J. SILBERBERG
Of Counsel

(2)* THE QUESTIONS PRESENTED start off on the wrong foot when they state "the premises....were surrendered". This ignores Judge Babitt's finding to the contrary. See page 19 of his opinion. We discussed the matter in our original brief at page 27. Appellee may not put to rest a material issue through conclusory statements of fact, let alone reverse a judicial fact finding.

The first two paragraphs (3) under Appellee's Statement of Facts seem designed to induce an erroneous interpretation that the giving of the guarantee was subsequent and unrelated to the making of the lease. This, as the record bears out, is not so. At the hearing before Judge Babitt on April 30, 1975, Mr. Mann, Appellee's attorney stated (see page 8 of transcript) the following:

> "The essential facts, your Honor, are as follows, as far as this application is concerned:
>
> "In 1970 a lease was entered into with the landlord's predecessor. There is no dispute as to that. The fee was then sold to the claimant until the present time.
>
> Thereafter, or simultaneously, a guarantee was executed by Unishops, the parent corporation. So, we have a tenant in possession and we have a guarantor."

All the documents were reviewed and made effective

*Note: Numbers in parenthesis refer to pages of Appellee's brief.

on 9/24/70, see dating of opinion letter, guarantee and deed. Copies are attached to the Agreed Statement of Facts (hereinafter referred to as FACTS).

Finally, ¶8 of FACTS, uses the word "simultaneously". The lease reads "made as of the first day of July 1970". This is the usual terminology of an agreement subsequently made but dated back. Obviously the entire transaction was closed on September 24, 1970.

The statement (bottom of 3), that the "Tenant....had ceased operations prior to September 3, 1974", purposely does not indicate precisely when the operations ceased. The inference, of course, is that operations were continuing up to September 3, 1974. The letter (FACTS) from White's Department Stores (Appellee's subsidiary) dated March 13, 1974 (copy attached to FACTS) addressed to Mr. Miller, Appellant's representative, indicates continuing operations, at least through March, 1974. Actually operations of one type or another continued right up to at least the end of September 1974. The subtenant bank, concededly, was there long after.

(4) Our assertion that there were continued accruals of rent as a benefit is criticized as one of the alleged "major departures from the record". This is not departure at all. Actually this is an understatement. Judge Babitt found that "the parent-guarantor's....subsidiary continues to remain in possession....and continues to collect rent from its sublessees",

see page 12 of his opinion. This, as indicated by the Judge, was occurring after March 1974.

(5) Our assertion that "four consecutive months of payment of rent by DIP Unishops, constitutes its adoption.... of the guarantee by conduct" is criticized as having "no reference to the record". FACTS ¶12 indicate that "no rent was paid....subsequent to February 19, 1974". The obvious and intended conclusion is that rents were paid through February. The very wording of the March 14, 1975 letter (copy attached to FACTS) bears out prior payments of rent.

The statement (5) that "this check is obviously not a Unishop....check" is quite pointless. The letter of March 13, 1974 (copy in FACTS) clearly indicates that White's was acting on behalf of its parent Unishops and its Creditors' Committee. Thus, Unishops was in control of the situation and through its subsidiary was paying rent for its own benefit, operating and deriving income, and should be charged with the expenses.

(5) Appellee says Appellant "infers" that "Unishops received $4,000,000 (the purchase price of the fee) as consideration for its guarantee". Appellee continues (5) to relate that Nemeroff was the fee owner who transferred the fee to Appellant. While Appellee does not specifically so state, he infers that Nemeroff and not Unishops received the $4,000,000. This is the first time in this case that any question was raised

as to who received the $4,000,000. Actually, the record does not disclose who was the immediate payee of the $4,000,000. The fact is that $4,000,000 was concededly paid - FACTS ¶3, and this was the inducement for the giving of the guarantee. The fact that ¶6 FACTS states that the fee interest was in Nemeroff does not mean he was the ultimate recipient of the $4,000,000. ¶6 factually asserts that Nemeroff had divested himself of his stock interests in White's, a wholly owned subsidiary of Unishops prior to the closing of the transaction with Appellant. Surely the retention of the fee interest was merely for purposes of conduit and Appellant's $4,000,000 had to be turned over to Unishops.

(5) Our statement that "receipts derived by DIP Unishops from active operation of its subsidiary, White's....between November 30, 1973 and May 1974, when active business operations continued unabated in claimant's premises...." is criticized as being without legal relevancy and having no basis in the record. We again point to page 12 of Judge Babitt's opinion, wherein he indicated that even after the default, operations continued by the debtor and its subsidiaries, and his opinion supports the legal relevancy thereof, in relation to the fact that reliance upon the guarantee was the basis on which these activities were allowed to continue.

Furthermore, Chemical Bank, FACTS ¶19, continued to operate on the premises as the subtenant of Middletown long

after the period. FACTS ¶19 also verifies that the department store building was not vacated until September 3, 1974. The right to collect rents from Chemical Bank continued throughout and thereafter.

Appellee in its contentions that we have departed from the record, as can be seen from the foregoing analysis, is grasping at straws and strains credibility. Further indicative of this, is the footnote (bottom of 4) wherein it is pointed out that ¶s11, 14 and 23 of the reproduction (FACTS) are different from the actual original stipulation. Appellee is correct. The variance was inadvertent. After the end of this brief at pages 10 and 11, we indicate graphically the variation, show its inconsequential character, and point out that the original more strongly supports us than our supposedly purposeful variant reproduction.

Furthermore, the reproduction was served upon Appellee and had the deviation been substantial or important, Appellee could and should have pointed it out. A timely correction would have been made. Appellee's allusion to the matter is simply an effort to put Appellant in a bad light with respect to an inconsequential matter.

(7) The statement that "the tenant had surrendered possession prior to its arrangement proceedings" runs counter

to Judge Babitt's finding of fact allusion to which is made infra at page 1. For the convenience of the Court, we quote the Judge at page 19 of his opinion:

> "I do not find that, under the evidence here, the mailed keys were voluntarily received by the claimant, and, accordingly, the lease was not terminated on September 3, 1974 when Middletown Center, Inc. filed its own petition for Chapter XI relief."

In support of the continuance of the lease, Judge Babitt correctly applied New York substantive law, that continued occupation of a subtenant is occupation by the main tenant. Further supporting our position, he held that it was unnecessary to apply New York law since under the American Anthracite case the right to collect rent was a benefit upon which Middletown's liability could be predicated. See Judge Babitt's opinion, bottom of page 19, top of page 20.

(8, 9) Appellee cites the various cases upon which Judge Frankel relied. We will not reiterate the discussion of them in our original Memorandum at pages 27-31, indicating their inapplicability to support the conclusion reached by Judge Frankel.

(11, 12) Appellee urges that the Grayson case mandates a decision against Appellant. We have analyzed that case at great length and will not do so again. It is interesting to note that Appellee's attorney himself, expressed doubt that Grayson laid down an immutable rule of law applicable under all circumstances to compel a conclusion that a guarantee was an unrejectable executed agreement.

At the hearing (see page 17 of transcript) before Judge Babitt, Appellee's attorney said:

> "Because under Grayson Robinson, the Court says you cannot reject a guarantee. I think if the Grayson Robinson case was reargued today, under a set of facts, it would be totally different."

At the risk of repetition, we point out that Grayson alluded to the "function of....guarantees in the reorganization process...." In the case at bar, the guarantee was contributory and crucial to the rehabilitation process. The debtor's existence as a viable entity capable of rehabilitation was preserved by the forebearance induced by the guarantee. Without the forebearance that existence would have been seriously impaired if not destroyed. Its operating subsidiaries would have been ejected and part of its income cut off.

Even assuming contrary to Grayson, that under no circumstances could a guarantee be rejected, it does not follow that a guarantee and the underlying obligations cannot be assumed. In our original brief we pointed out that the debtor, having received the benefits of the guarantee, must in good conscience and equity be deemed to have assumed the guarantee and lease obligations as an incident of its use and occupation.

Avorn Dress case (13)does not hold that the Court must sanction the assumption by a DIP of every obligation.

Obligations arising in the usual course of a DIP's business need no court order to validate it. Unusual obligations so arising, however, do require such a court order. The question here is whether, being unrejected, it continued beneficially operative so as to constitute the basis of an administrative claim. Incidentally, we note that Appellee in arguing (13) that it could not be held to an assumption of the guarantee without a court order contradicts (12) this assertion when, in substance, he argues that neither the debtor nor the court can sanction such an assumption.

We do not disagree with Matter of Bohack (15). Mere lapse of time during which there is neither rejection nor affirmance does not mandate a holding as a matter of law that there has been acceptance of an obligation so as to prevent rejection. Had it been demonstrated in the Bohack case, that the obligation involved had been beneficial to the debtor, the decision would have been otherwise. In the case at bar that has been amply demonstrated.

Appellee completely ignores In re Chase Commissary relevant to the question and cited at page 24 of our original brief. The two months' rule therein enunciated is more than satisfied in our case by payment of four consecutive months of rent.

The recognition of Unishops and its subsidiaries as separate entities (15) was for narrow jurisdictional purposes,

namely, the parent's Chapter XI proceeding did not give the court jurisdiction to enjoin proceedings in other forums against its subsidiaries. Jurisdictional separability does not destroy the factual nexus and interrelationships between parent and subsidiaries as the basis for holding that benefit to a subsidiary through whom the holding company parent transacts business benefits the parent.

The Grayson case indicates this court's awareness that a parent's guarantee of its subsidiaries' obligations could, under appropriate facts, inure beneficially to the parent warranting a construction of such guarantee as executory with resultant benefits to the parent apart from benefits to the subsidiary lessee. Judge Babitt strongly considered this case to be within that category so that Appellant's claim should be entitled to administration status. He did not take the ultimate, logical step dictated by his reasoning. He preferred to have this court sanction his interpretation of the Grayson case.

Respectfully submitted,

RUBEN SCHWARTZ & SILVERBERG
Attorneys for Appellant

ALBERT LYONS
SEYMOUR J. SILBERBERG
Of Counsel

ILLUSTRATION OF DIFFERENCES BETWEEN ORIGINAL AGREED STATEMENT OF FACTS AND REPRODUCTION.

Original of ¶ 11 Except Parenthesis Supplied for Purposes of Illustration.

11. Between such filing and September 23, 1974, an interval of ten consecutive months while Unishops Inc. remained debtor-in-possession, (the debtors and the claimants respectively, did not reject, liquidate, resolve, determine, settle, release, litigate or otherwise alter the aforesaid lease or guarantee of the obligations thereof, nor did the debtors assign any rights as against subtenants or licensees, to the claimants.)

The portion in parenthesis above is not in the reproduction.

Reproduction of ¶ 11 Except Parenthesis Inserted for Purposes of Illustration.

11. Between such filing and September 23, 1974, an interval of ten consecutive months while Unishops Inc. remained debtor-in-possession, (no change in status, of either the aforesaid lease or of the aforesaid guarantee, was effected either by conduct (of lessee Middletown Center Inc., guarantor Unishops Inc., or the claimants) or by operation of law.)

We submit that a comparison of the two parenthesized portions reveals no substantial or material difference. In fact, appellant believes the original is more advantageous to its position.

Original of ¶ 14.

14. The debtors aver, which claimants cannot controvert (and debtors will prove if so required by this Court) that they have neither demanded nor have they received any money for occupancy under sublease or license in connection with the parcel in question, with the possible exception of a March 5, 1974 payment from Waldbaums; that a proposed sum by way of full settlement of sublease obligations as between the debtors and Waldbaums was tentatively agreed upon but not consummated.

The only difference between the original and the reproduction is that the last two words of the reproduction are "never performed" instead of "not consummated". The difference is too slight to require comment.

Original ¶ 23 Except Parenthesis Supplied for Illustration.

23. Since the filing of its petition herein, debtor Middletown Center Inc. has taken no affirmative steps to collect any of the rental or other charges due to it from Chemical Bank or its other subtenants and/or licensees for the month of March 1974 et seq (except for attempts to consummate tentative settlement with Waldbaums.)

The only difference between the above and the reproduction is that the parenthesized part is not in the reproduction. Appellant considers the original more favorable to its position.

11 20 a

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Date 6/12 19 79

LEVIN & WEINTRAUB

Attorneys for Debtors